

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BLUE GRASS ENERGY)
COOPERATIVE CORPORATION FOR APPROVAL)
OF THE CONVERSION OF CFC NOTES 9006, 9009,) CASE NO.
9011, 9012, 9013, 9018, 9019, 9020-001, 9020-002,) 98-295
9020-003, 9021-001, 9021-002, 9014, AND 9015 FROM)
VARIABLE TO FIXED RATE LOANS)

O R D E R

On May 8, 1998, Blue Grass Energy Cooperative Corporation ("Blue Grass") filed a request that the Commission approve the conversion of certain loans approved in its prior Orders entered in Case Nos. 6116, 6027, 7115, 7769, 9694, 8726 and 89-031¹ to authorize the conversion from a variable to a fixed interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9006, 9009, 9011, 9012, 9013, 9018, and 9019. On June 22, 1998, Blue Grass filed an additional request that the Commission also approve the conversion of certain loans approved in its prior Orders entered in Case Nos. 89-031, 95-222, 9694 and 90-352² to authorize the conversion from a variable to

¹ Case No. 6116, Order dated November 24, 1974; Case No. 6027, Order dated May 29, 1974; Case No. 7115, Order dated June 19, 1978; Case No. 7769, Order dated April 21, 1980; Case No. 9694, Order dated November 25, 1986; Case No. 8726, Order dated April 23, 1984; Case No. 89-031, Order dated March 29, 1989.

² Case No. 89-031, Order dated March 29, 1989; Case No. 95-222, Order dated July 25, 1995; Case No. 9694, Order dated November 25, 1986; Case No. 90-352, Order dated March 12, 1991.

fixed interest rate for CFC Loan Nos. 9020-001, 9020-002, 9020-003, 9021-001, 9021-002, 9014 and 9015. Blue Grass is requesting approval after the fact for the conversions since the loans were converted by CFC on May 1, 1998 and July 1, 1998, respectively, and subject to Commission approval. These loan conversions were approved by Blue Grass's Board of Directors on March 19, 1998.

When converting to a different interest rate option, CFC requires the payment of a conversion fee unless the loans have reached the end of the term. The loans Blue Grass is seeking to convert are at the renegotiation period and are not subject to the conversion fee. The terms of the loans provide for a fixed interest rate for 12, 14, 23, 25 and 26 years, after which, they can be repriced at various options.

Blue Grass stated in its application that its review indicates that there are potential savings and interest rate stability by converting from the variable rate to the fixed rate. The variable interest rate applicable to these loans, at the time of conversion, was 6.55 percent. Blue Grass has converted the loans to a fixed interest rate of 6.95 percent for a 12-year period, 7.00 percent for a 14-year period, 7.10 percent for a 23-, 25- and 26-year period. When converting to a fixed rate, CFC offers a performance discount that lowers the effective cost. For example, Loan No. 9015, for a 26-year period with a fixed rate of 7.10 percent, after factoring in a performance discount of .125 percent, results in an effective cost of 6.429 percent.

In recent years the Commission has approved financing giving the cooperative the option of selecting the interest rate option which results in the lowest cost of money to the cooperative at the time the funds are first drawn down. These orders further provided that

refinancing could occur at the discretion of the cooperative under the terms of the financial arrangements with the lender. Loans approved in Case Nos. 9694, 89-031, 95-222 and 90-352 were approved under such arrangements and do not require Commission approval to convert. The other loans were approved for fixed terms and conditions and provision for conversion at the discretion of the cooperative was not included in the orders approving the financings. The conditions under which the converted loans will operate are the same as other CFC loans currently approved by the Commission. These conditions provide for the cooperative to reprice loans at various periods without conversion fees. The Commission is of the opinion that the cooperative should be able to take advantage of these options without further orders provided that the interest rate program selected results in the lowest cost of money to the cooperative. Therefore, the loan conversion approvals in this case should provide the authorization accorded other loans.

Blue Grass repriced its loans that are the subject of this proceeding prior to obtaining Commission approval. CFC made the repricing contingent upon Commission approval and stated in the letter approving the repricing that if the Commission did not approve the conversions, it would reinstate the previous rate retroactively. In the event there was a differential in the interest rate, Blue Grass would have to remit the difference. In this instance the interest rate has increased since the time that Blue Grass exercised its option. Under the arrangements with CFC, Blue Grass would not be liable for any increased cost above what it would have incurred if it had not exercised its option prior to obtaining Commission approval. The Commission is concerned about the fact that Blue Grass refinanced its loans prior to Commission approval and is also concerned about the

regulatory procedure which requires prior Commission approval to exercise loan options. The Commission has granted blanket approval for CFC loans authorized in recent years, which allows the cooperative to exercise repricing options. The Commission likewise believes that this authority should be extended to the loan conversions being approved in this case. It should be pointed out that Blue Grass will still have CFC loans that do not provide for changes without prior Commission approval. If Blue Grass wants to exercise repricing options on any of those loans, it should file an application prior to the repricing date in order to obtain prior Commission approval in the future.

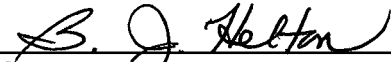
Based upon Blue Grass's analysis, the conversions of the loans should result in interest savings and should be converted as requested.

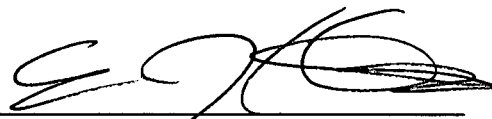
IT IS THEREFORE ORDERED that:

1. The Commission's Orders entered in Case Nos. 6116, 6027, 7115, 7769 and 8726 are modified to authorize the conversion from a variable to a fixed rate program for CFC Loan Nos. 9006, 9009, 9011, 9012, and 9018.
2. Blue Grass shall file all documents pertaining to the conversions.
3. All other provisions of the Commission's Orders entered in Case Nos. 9694, 89-031, 95-222, and 90-352 shall remain in full force and effect.

Done at Frankfort, Kentucky, this 25th day of August, 1998.

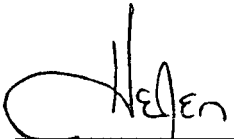
PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

